Economic roots of instability in the Middle East.

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We have good reason to think of the Middle East as chronically unstable. The region has been the scene of four large-scale, modern wars during the past two decades (the 1973 October War, the Israeli invasion of Lebanon in 1982, the Iran-Iraq War and the Gulf War of Desert Storm). The Iranian revolution of 1978-79, the taking of American embassy personnel as hostages, the bombing of the U.S. embassy in Beirut, and the Palestinian intifada have further focused ou attention on regional political violence. Today, in the aftermath of the relative stability achieved by Desert Storm, the rise of internal war and terrorism led by Islamic radicals in Algeria, Egypt, Lebanon and Palestir causes concern. Such radicals now govern two states of the region, Ira and Sudan. The high drama of regional politics, overt military conflict, and internal war and terrorism understandably captures the public imagination and shapes all of our perceptions of the region.

But there is a quieter, deeper source of instability: mounting economic problems. The Middle East is increasingly falling behind not merely the advanced industrial countries of the West and Japan, but also rapidly growing areas of the developing world like East Asia, and (now) Latin America. With only a few exceptions, Middle Eastern governments hav done a poor job of overcoming past economic policy mistakes and mismanagement. Their inability to curb population growth over the pa three decades has engendered a rising tide of young people seeking jobs. Political leaders' failure to overcome vested interests and arbitrary political rule has discouraged private investment, even as governments could no longer honor their populist promises. The resulting rise in **unemployment** and the fall of real wages fuel the spread of Islamic radicalism among the region's youth. The employment problem constitutes the most politically destabilizing economic challenge in the region.

But however daunting the challenge of job creation, it is not the sole difficulty. The region faces a quietly increasing challenge to acquire adequate food. The region cannot feed itself: food dependency will grow in the immediate future, as the water constraint binds more tightly. Rising water scarcity dooms autarchic food-security strategies: rising share of water must be used for domestic and industrial use, leaving less for agriculture. The region must export in order to eat and to create jobs for the young. The money needed for job creation, industrial expansion and export promotion must come largely from the private sector. The pressures of jobs, food, water, and money will quietly, inexorably press against rigid political systems, eroding region political stability.

There is a way out: The economic policy responses to these challenges are reasonably clear. The technocrats know what to do; the problem is that political leaders may lack the will and skill to pull it off. Weak political systems may well deliver "too little, too late." The belated recognition of the need to stimulate private investment may succeed in some countries. On the region's periphery, Morocco and Tunisia have scored some modest successes, as has Turkey. However, it would be most unwise to suppose that all of the diverse national political system in the region will be able to cope with the problems of jobs, food, wat and money.

Trouble is coming. Indeed, it is already here. The recent upsurge of fighting in Yemen partly reflects that country's utter failure to cope wit economic challenges in the wake of the economic disaster (largely of their own making) of the Gulf War. Similarly, much of Algeria's collaps into internal war may be traced to economic incompetence. Although Egypt reaped very significant windfalls from the war, the government pursues economic reform at a glacial pace. Meanwhile, the country's labor supply grows exponentially; the upsurge of terrorism is, in substantial measure, the fruit of the mismatch. Given the magnitude o the problems, it would be prudent to expect similar problems to emer elsewhere in the region.

Let us briefly examine the key economic challenges facing the region in the years ahead in slightly more detail.

JOBS

The employment problem is perhaps the most politically volatile economic issue for the immediate future. Although available data are highly uneven quality and often not comparable across national boundaries, several generalizations may be made:

* Current levels of **unemployment** are high;

* The problem will get worse;

* It primarily affects young, semieducated people, whose anger fuels political unrest.

The interaction of three factors explains these outcomes:

* The supply of labor is growing very rapidly, but

* The demand for labor is expanding only sluggishly, will

* Large public sectors have created particularly inflexible labor markets

There is much variation in officially reported **unemployment** rates. Although there exists an "international *definition*" of **unemployment,** used by the International Labor Organization (ILO) of the United Nations, only the West Bank and Gaza use this very restrictive **definition.**(2) Other reasons for the wide variability of rates include differences in treatment of the informal sector, variable counting of women's work and changes in the size of the labor force itself as economic growth stagnates. All numbers on **unemployment** in the region must be taken with several truckloads of salt. We should use ou common sense- -and round numbers.

Despite these data difficulties, four heroic generalizations may be mad

* Urban **unemployment** exceeds rural;

* **Unemployment** among the young is much higher than for older workers;

* Women's measured **unemployment** rates exceed men's; and

* Educated workers are more likely to be unemployed than the unskilled.

Unemployment is largely an urban phenomenon. Agricultural and informal rural labor market outcomes are best explained with supply-and-demand models, i.e., wage flexibility prevails in these markets. Thi is not to say that farm labor markets are the perfectly flexible, instantaneously clearing markets that are described in introductory textbooks. There is some small-sample survey evidence that labor markets don't clear even in the peak season in Egypt; such information seems compatible with some kind of "efficiency wage" argument. But most evidence (such as it is) suggests wage flexibility. Clearly, both seasonal **unemployment** and so-called "underemployment" also exist, although the latter term is problematic (too often just a code word for poverty). Finally, rural-urban migration reduces the rate of growth of rural labor supply; to an important extent, **unemployment** is exported to the cities, which are growing by about 4.5 percent every year.

Unemployment is mainly a problem of the young. Nearly half of unemployed Moroccans are between 15 and 24; 75 percent of unemployed Egyptians are new entrants to the labor force. To some extent, of course, this is always true. For example, in OECD countries, youth **unemployment** is roughly 2-3 times higher than prime-age **unemployment.**(3) Much the same is true in the Middle East. To some extent, high **unemployment** in the region is a demographic phenomenon, in which the higher proportion of young people in the labor market automatically raises the overall **unemployment** rate. In Egypt, for example, between the two census years of 1976 and 1986, the proportion of the labor force 15 to 24 years old rose from 22 percent to 31 percent.

Some youth **unemployment** is what economists call "voluntary" or "frictional" **unemployment:** more young people are "between jobs" tha is true for older workers, simply because the young can change jobs more easily, have less seniority to bind them to a given employer, etc. But this is hardly the whole story. Many young people lack the marketable skills necessary for private-sector work. Further, many hope to find a government job and register themselves as unemployed in order to remain in public job queues. Such jobs are not being created, because governments are running out of money. Consequently, old bureaucrats with job security sit stolidly astride the traditional path of upward mobility of young urban men. To some extent, the conflict between Arab nationalists and Islamists is a generational conflict, a fig between fathers and sons.

Unemployment is partly a gender-based malady. Outside of the Gulf, female **unemployment** rates are greater than male rates. In the Gulf, the reverse is true, but this may simply be a statistical artifact, in which women who can't find a job are defined out of the labor force. Strong social conventions restrict the **definition** of "respectable work." Since nearly all women in the region are married, they can more easily remai unemployed if necessary to "maintain family honor." (Men, of course, engage in similar behavior; Jordanian **unemployment** coexists with th immigration of unskilled Egyptians because young Jordanian men do not want to accept work that they, their families, and--perhaps especially important--prospective spouses' families find "demeaning.") I this regard, men, but especially women, are adversely affected by the decline in (eminently respectable) public- sector jobs.

Finally, **unemployment** is especially an affliction of the educated.

Despite some skepticism, most evidence suggests that **unemploymen** is concentrated among the relatively educated. In Jordan, **unemployment** increases precisely with education: in 1991, just over percent of illiterates were unemployed, while university graduate **unemployment** was over 20 percent. In Egypt, the highest rates of **unemployment** are found at intermediate educational levels (roughly 30 percent); for university graduates it is about 15 percent, while nearl all illiterates have jobs (**unemployment** rate of 3 percent). As one observer has put it, "Urban **unemployment** is...in the nature of a waiting list from which those who have virtually no hope of a job by reason of personal handicap (no primary education or professional training) have struck themselves off."(4)

Unemployment is the result of the number of school leavers growing faster than the number of jobs created in the modern sector. Unemployed youth have too little (or the wrong kind of) education to compete in the modern, formal-sector labor market, but too much education to be willing to accept an unskilled job. **Unemployment** is highest among secondary-school leavers, who are, perhaps not coincidentally, also increasingly prominent in radical Islamic groups. It seems that "a little knowledge is a dangerous thing."

Difficult as the problem is at present, there are reasons to fear that it will get worse in the years ahead. The challenge of job creation is daunting, simply because of the rate of growth of the number of new entrants to the labor force. The region's labor force is growing at a rat of about 3.1 percent per year, the fastest rate in the world.(5) At this rate, the region's labor force will double by the middle of 2016--less than 23 years from now. In ten years, there will be one- third more people--all of them young--looking for work. By the turn of the centur the region's labor force will be roughly 25 percent larger than it is today. Put differently, between now and the end of the decade, the Middle East's labor force will grow by over 20.5 million--which is abou the combined size of the current labor forces of all Asian Arab countri (approximately 21.2 million)!

Labor forces are growing rapidly thanks to past population growth, which has declined only gradually in most countries in the region. At t same time, as more and more women receive education, they increasingly seek jobs. This has created particular tensions in the Arab world, where the sense of competition from women who "ought to be at home lends credence to simplistic religious politics and contributes the appeal of the sexual politics of the Islamic radicals. The cry "make them go back to the kitchen" makes sense to unemployed young Musli men and lends credence to other simplistic slogans.

If the economies of the region were growing rapidly, if investment we being allocated efficiently, then many more jobs could be created. But the sluggish overall growth of these economies means that the numbe of new jobs is swamped by the number of new job seekers. During the 1980s, the economies of the region grew at only about 0.5 percent pe year, while population growth exceeded 3 percent. Since the mid-1980s, the picture is worse. In Egypt, for example, it has been estimate that the economy needs to grow at about 7 percent per year simply to keep **unemployment** from rising. But since the mid-1980s, the Egyptian economy has essentially stagnated, registering a real GDP growth rate of about 2.6 percent.

The reasons for such sluggish growth are well-known, and space permits only the briefest sketch. Two interrelated forces were responsible for the dreary performance: (1) the end of the oil boom, with its large increases in national income through the direct (oil exporters) or indirect (labor exporters) collections of oil rent, and (2) th need for structural adjustment, as the deficiencies of a former era of state-led, import-substituting industrialization became increasingly evident. And, of course, the 1990-91 Gulf crisis and war had very serious negative consequences for incomes in the region. Labor exporters whose leaders backed the losers (Jordan, Yemen, the Occupied Territories) were especially hard hit.

Statist development strategies have contributed to **unemployment** in second way. A large percentage of workers in the Middle East toil for the government.(6) Public-sector or administered labor markets are much less flexible than private-sector markets. Since labor-market inflexibility is positively associated with **unemployment,** large public sectors contribute to high rates of **unemployment.** Although the decline in public-sector real wages may have reduced some of the appeal of these jobs, they remain highly valued for their security and a "bases" from which extensive moonlighting is possible. The chances to collect petty rents (bribes, in plain English) is also an attraction. Educational systems have long been designed to produce civil servants further exacerbating the problem.

As noted earlier, some of those officially counted as "unemployed" are actually simply registered on government-job waiting lists while they i fact work in the informal sector. From an economic point of view, it makes a considerable difference whether a young graduate is unemployed or working in the informal sector. From a political perspective, it may matter much less: in either case, he is disappointed and disillusioned. He may have a job, but he believes that his job is demeaning. He is employed, but he is also frustrated. The steadily increasing number of unemployed young people is a political timebomb.

FOOD AND WATER

A second source of instability (but one which is often much misunderstood) is that of food security and water scarcity. On the one hand, it is often correctly noted that the region is already dependent o imports for a substantial fraction of its food consumption. On the othe hand, it is often asserted that "water wars" are a likely future threat to stability in the region. But regional "water scarcity" is fundamentally driven by agricultural use, which consumes over 4 out of 5 gallons of water everywhere outside of the Gulf. The water constraint suggests that food-import dependency will probably increase in the years aheac The regional obsession with "food self-sufficiency" does much to create water shortages. There are sensible, practical technical and economic solutions to both problems. However, there is doubt as to their politica feasibility in some cases.

"Food security" is an insurance concept. Ensuring food security means guaranteeing that consumers are reasonably certain of being able to e properly. All too often, however, students of the region conflate "food security" with "food self-sufficiency." Politicians, in particular, seem unable to resist the siren song of alimentary autarchy. Let us be clear: Food self-sufficiency for most countries in the region is impossible, anc this is no bad thing.

The "stylized facts" of the political economy of food during the oil-boor decade may be sketched as follows. Rapidly increasing populations an swiftly growing per capita incomes quickly raised the demand for fooc The increase in incomes was not limited to oil exporters but was also enjoyed by the poorer countries, thanks to large-scale migration for work in the oil-exporting countries. Domestic supply response was sluggish, thanks to the "Dutch Disease" (living on rent rather than productive effort), to a continuation of policies which excessively taxec the agricultural sector, and to limited investment in the agricultural sector. Cereal production was especially weak, caught between rising labor costs, marginal rainfall and government-imposed price disincentives. By contrast, the production of higher-value crops like fruits, vegetables and livestock did much better. There were also two countries whose agricultural performance stood out above the others: Syria and Sudan. But almost everywhere, the food gap could be plugged with imports: abundant foreign exchange and improving tern of trade permitted a dramatic increase in food (and especially cereal) imports.

The rise in the percentage of Arab consumers' food which came from abroad was disquieting to policy makers, who feared that reliance on foreign supplies was risky, whether economically or politically. Responses to these fears were already evident in the early 1980s. Subsidies of inputs usually either continued or increased, while taxatio of output through price policies typically eased. Arab governments often began to allocate a higher share of investment to agriculture, an many urban entrepreneurs entered the production of horticultural crops, poultry and livestock. Much hope was placed on the developme of Sudan as the "bread basket" of the Arab world, and Arab bilateral ar multilateral aid flowed into projects in Central Sudan (Darfur, Kordofar Blue Nile). Visions of an Arab world self-sufficient in most food dancec before the weary eyes of agricultural and strategic planners.

This doomed vision always rested upon a fundamental confusion: fooc self-sufficiency is neither necessary nor sufficient for food security. The food security idea recognizes that we all live in a risky world and seeks to devise public policies to minimize the risk that consumption of food will fall below some minimally acceptable level. A country (or a household) can attain such security in three ways: by producing the food, by trading for it or by having it given to them. Governments' relentless pursuit of food self-sufficiency has failed on its own terms: Arab countries are, on balance, no better (or worse) off today with respect to food self-sufficiency than they were a decade ago; however, their food-security positions are often more precarious.

During the 1980s, the rate of growth of the demand for food decelerated and was almost exclusively the result of population growth.(7) The rate of population growth for the Arab world as a who during the 1980s was just under 3 percent per year, rising from roughl 155 million to some 208 million.(8) The Arab world "added an Egypt" during the 1980s (some 53 million new people, roughly the populatioı of Egypt in 1990). There was no tendency for the overall rate to decelerate during the decade. Such a rate of population growth implie a doubling of population by 2015, when there will be 415 million Arabs.

Although total fertility rates (approximately "the number of children which an average woman will have") have fallen in nearly all countries, even under optimistic scenarios Arab countries' populations will not stabilize for at least another generation. There will continue to be man more mouths to feed. On the other hand, in sharp contrast to the decade of the oil boom, per capita incomes stagnated in most of the region.

What of the supply response? Most Arab countries' agricultural sectors managed to keep up with population growth during the 1980s, but only in Egypt and Morocco did farm production outstrip population increases. For most countries, there was little change in cereal self-sufficiency. Only Morocco and Saudi Arabia reduced their dependence on trade as a source of staple food consumption during the decade. Fc most Arab countries, population grew, cereal production stagnated, ar cereal self-sufficiency remained unchanged. It follows that per capita consumption of cereals declined in most Arab countries. Cereal self-sufficiency of most Arab countries remained unchanged, while "cereal security" declined for many Arabs.

The increases in output were largely the result of additional inputs. Th arable area continued to increase in those countries that experienced the strongest agricultural growth, and irrigated land expanded nearly everywhere. Fertilizer use increased at a diminishing rate. Mechanization, especially tractorization, continued unabated throughout the region. The total number of tractors in the Arab world rose by over 55 percent during the 1980s, an increase of over 138,000 tractors. The farm-labor force either continued to grow or resumed growing after an "oil-boom- induced decline" in most countries. The oi boom of the 1970s drew labor out of agriculture: in Algeria, Iraq, Jordan, Syria, Yemen, Libya and Egypt, the adult male farm-labor force actually declined during the 1970s. However, the 1980s largely reverse this "Dutch Disease" phenomenon in all but Iraq, Jordan and Libya. The numbers for Jordan might well look different today, in the wake of the return of migrants from the Gulf. In short, Arab agricultures used more land, more water, more fertilizer, more machines and more labor--all just to keep up with population growth.

In a sense, Arab countries held the line on food self-sufficiency while permitting (or being unable to prevent) a deterioration in food security The "relative success" on self-sufficiency was in an important sense the fruit of stagnation: only because per capita incomes stagnated was domestic supply able to keep pace with domestic demand, now reduc to population growth alone. Further, the decline in the apparent per capita consumption of cereals is disturbing. This, combined with the continued rapid expansion of luxury foods like fruits and vegetables, is consistent with a hypothesis of increasing inequality of income distribution in many countries. It is also very likely that poverty rose in most countries simply because of the failure of growth. Such a development bodes ill for food security at the household level.

In any case, it is simply false to equate food security with food self-sufficiency in the Arab world: relying on "own production" is highly risky. The common conflation of food security with self-reliance tacitly assumes that own production is a less risky mode of satisfying domest demand than is dependence upon international trade. Evidence suggests otherwise. Cereal production remained highly variable in the region, as weather shocks continued to plague staple food production Only Egypt, with its entirely irrigated agriculture, escaped from repeated weather shocks. In Syria, for example, food production woulc fall below the average by more than 5 percent every third year. Cereal production remains a very risky gamble on the rains. There is little evidence of either marked improvement or deterioration in variability over time for the region as a whole. Such variability has important implications for food security.

Fundamentally, the region cannot escape its geography: water is, and will become increasingly, scarce in the region. So long as water is needed for photosynthesis, there will be serious barriers to the achievement of "self-sufficiency" in food or agriculture anywhere outsi of Turkey or (potentially) Sudan. Outside of the Gulf, agriculture uses the lion's share of water. Water problems are especially acute in the Mashreq and the Arabian peninsula, where unsustainable rates of usag are increasingly common. Further, increasing pollution of water is also growing problem. Saudi Arabia's vaunted self-sufficiency in wheat has been achieved by heavy financial subsidies and unsustainable exploitation of ground water exporting water, in effect. Food self-sufficiency is an expensive, wasteful, and ultimately doomed food-security strategy.

Fortunately, food security can be obtained in another way: through trade. Few would argue that Singapore or Korea fail to enjoy food security. Middle Eastern political economies will have to emulate other economically successful but agricultural-resource-poor nations to achieve food security in the years ahead. Increasingly, Middle Eastern nations must export in order to eat.

MONEY

This brings us to the final critical challenge facing the region, the shortage of capital. Given the vast financial resources of the Gulf, it ma seem odd to posit such a shortage. However, the Gulf War has made it clear that the capital-rich states will invest their money only where it earns the highest return. Appeals to "Arab unity, " always hollow, have now been relegated to the history books. Calls by analysts to "share th oil wealth" are equally misplaced. Instead, the call should be to create climate so that already existing savings can be properly allocated.

Many countries of the region do have a "debt problem," but in some important cases, there has been some improvement recently. Egypt skillfully used its participation in the Gulf War coalition to reduce its debt by roughly 50 percent, stanching some $2 billion of yearly debt-service outflows. But in Jordan, for example, debt-service payments consume nearly one-third of exports. All countries of the region compete with Eastern Europe and the countries of the former Soviet Union for capital investment. And the need for investment in more sophisticated technologies for production and distribution, for cities and farms, for communications and educational facilities, is extremely large. To take only one example the World Bank estimates that the We Bank and Gaza will need \$2.4 billion over 5 years. The government of Lebanon believes that it will need over \$10 billion merely to repair infrastructure. The needs in Egypt (\$57 million) and the Maghreb (\$60 million) are far larger.

But international indebtedness is not the root of regional capital scarcity. Neither can we blame deficient savings propensities: there is r evidence whatsoever that Middle Easterners do not save. Egypt offers useful illustration: the estimated "off-shore" holdings of hard currency by Egyptians exceeds \$80 billion, nearly twice the size of Egypt's currer international debt. In 1988, gross investment in Egypt was about \$3 billion at 1988 official exchange rates. The estimated \$6.2 billion of Jordanian external savings is over 160 percent of Jordan's GNP, Syria's \$26.1 billion is over 160 percent of its GNP. Middle Eastern savings are abundant.

The capital problem in the Middle East is fundamentally institutional. First, highly inefficient statist economies generate far less "bang for the buck" than do market economies. Indeed, the efficiency of investment has been falling in the region during the past decade. In 1970-74, it took about \$3.50 of investment to generate an annual stream of \$1 of income in the Mashreq. In the late 1980s, it took over \$7.50, and in 1988-91, over \$13.00! Second, savers and investors (with good reason fear and distrust national governments. Specifically, they fear that thei savings will be expropriated either directly by state decree, or by stealt via rampant inflation and overvalued exchange rates. Unsurprisingly, they hold their savings off-shore or in highly liquid form. Only if genuine political reform creates secure private-property rights and an independent judicial system to enforce those rights will the savings of Middle Easterners be placed inside their own countries, and, still more difficult, in the kind of illiquid, fixed-capital investment (like factories) that the region needs to produce goods to sell abroad to buy food anc to create jobs.

From an instrumentalist economic point of view, it makes little difference whether the legal system that protects property is based on common law, the Code Napoleon, or the Sharia. Far more important than any of the details of the relative efficiencies of these different systems is the need for some predictable legal system to replace the capricious, confiscatory state power that has dominated regional political economies since the 1950s. Arbitrary governance in many states undermines business-sector confidence, deterring the kind of relatively illiquid investments which are necessary to create jobs. Without an expansion of the rule of law, there is little chance that private investors will fill the breach that governments can no longer fil

CAN IT BE FIXED?

We know what is broken, and we know how to fix it. The economics o ameliorating the interrelated problems of jobs, food, water and mone are reasonably clear. Fundamentally, a solution requires adopting a ne development strategy, one that stresses the role of the private sector i developing the production of goods and services for export. By stimulating private investment in industries where a country has a comparative advantage, such a strategy reduces the burden of debt, creates jobs and buys food, thereby reducing the strain on scarce wate supplies. The solution to the most critical problem--jobs--is simultaneously the answer to the problems of food and water. Export-led growth must, however, be driven fundamentally by private-sector investment.

Stimulating such investment--finding the money necessary to solve the jobs, food and water problems--requires significant shifts in economic policy. Again, there is something approaching consensus on the broad outlines of what is needed. Governments must stop doing some thing (e.g., excessively and arbitrarily regulating business; maintaining inefficient state-owned enterprises), start doing other things (e.g., providing infrastructure and the rule of law), and do some things bett (e.g., providing sound macroeconomic management; educating children; tailoring educational systems to labor market requirements). We have much international experience with economic reform. We ha a reasonably clear picture of what works, what doesn' t, and why.

The problems are fundamentally political, not technocratic. As everywhere in the world, vested interests block change. Political leadership is often deficient, lacking any more vision than daily surviva Political systems are weak, with few institutions to manage change in orderly, nonviolent manner. The rule of law is fragile everywhere, and the volatile regional state-system further erodes investors' confidence.

Political blockages to economic reform seem to be especially acute in countries whose regimes have Arab-nationalist origins and appear to b somewhat less so in Arab monarchies. In most of the former (Algeria, Egypt, Syria, Yemen), the regimes' primary political constituency (main state-owned-enterprise employees, government bureaucrats and political-party hacks) stand to lose the most from economic reform. These regimes also spent decades grounding their claims to legitimacy in an ideological commitment to equity based on state enterprise. Unsurprisingly, they have done the least to reform their economies anc are in very considerable trouble.(9)

By contrast, monarchies such as Morocco, Jordan and Saudi Arabia hac very different political constituencies and claims to legitimacy, claims which often give Islam a much larger role. Accordingly, the configuration of both interests and ideology makes reform relatively easier. But such regimes, too, face considerable difficulties with entrenched interests and excessive past promises of state largess, as th ballooning Saudi government deficit attests. Like their Arab- nationalis neighbors, they often also lack the political institutions which a moder private-sector-driven economy requires.

Even the most skillful reformists can be unlucky, as was King Hussein when Saddam invaded Kuwait, forcing him to tilt toward Iraq, with devastating consequences for Jordan's economy and economic reform program. The combination of entrenched interest groups, weak politic leadership, feeble political institutions and the risk of external shocks makes it highly unlikely that all, or even most, of the countries of the region will be able to implement the necessary policy changes. The structure of the regional state system is such that failures in one count (e.g., Egypt) can easily spill over into others. The most plausible medium-term scenario includes considerable political instability in the region as at least some states fail to cope with the problems of jobs, food, water--and money.

IMPLICATIONS FOR U.S. POLICY

The first implication is fairly obvious: we should expect trouble. We should not let either satisfaction with the current, fragile status quo in the Gulf, or with the progress to date of the peace process, blind us to coming storms. Continued vigilance and maintenance of appropriate military force remain essential. Roughly every three years, a major, typically unexpected event in the region upsets the status quo. Althou we can try to ameliorate crises, we should not expect to succeed in all even in most cases, simply because there are too many factors that lie beyond our control. Above all, the mixture of oil, the proliferation of weapons of mass destruction and the deep forces of instability sketche above demands that the region receive the serious, sustained interest top policy makers.

A corollary of this implication is the need to formulate an effective energy policy. The Clinton administration at least tried to implement every economists' favorite method to save energy, imposing taxes to raise prices to consumers. Despite such a policy's unpopularity, it remains the only way to reduce dependence on Gulf oil supplies. It seems likely that we will fail to do this, and, accordingly, will face mor unpleasant choices in the future. But the option remains available, if w choose to adopt it.

A second implication is that we should work very hard to strengthen three key states: Turkey, Egypt and Morocco. If these countries can overcome their core development problems, then regional stability wil be greatly enhanced. If any of them fails, the consequences will be extremely serious. In all three cases, the fundamental political will and vision must be internal; such commitment seems to be present in Turk and Morocco. The commitment of the top leadership in Egypt to genuine economic reform appears to be less certain. But apart from persuasion, outsiders can do little here.

Nevertheless, there are things which we outsiders can do to help our friends, the market reformers. Europeans and Americans should adher to an economic Hippocratic Oath: "Do no harm." Continued open markets for goods and careful, reciprocally negotiated agreements on immigration with the European Union (EU) are crucial for economic success in all three countries, but perhaps especially for Turkey and Morocco, whose main markets are in Europe and whose political leaderships have staked their futures on continued integration with th KU. We need to remind our European friends that closer integration of both Morocco and Turkey with the EU is, in Paul Krugman's phrase, a question of "foreign policy, stupid!"(10) The economy of the EU is vastl larger than those of the Maghreb and Turkey; for Europe, as for America, there will be no "giant sucking sound" taking jobs south and east if there is closer integration between the EU and the Maghreb anc Turkey.

We should encourage European politicians to say, loudly and clearly, that the closer integration of North African and Turkish economies witl the EU is necessary for European security. Of course, some European special interests (in labor-intensive manufacturing and, especially, in agriculture) will be adversely affected; these will, as always, dress up their special pleas in the rhetoric of national interest. Responsible politicians must point out that free trade helps Europeans, but helps fa more the Maghreb and Turkey. They must stress that the issue is, indeed, "foreign policy, stupid!"

We can also help with debt relief. Both Morocco and Turkey suffer fror a substantial "debt overhang," which discourages investment. Large public debts weaken financial systems and deter long-term capital investment because investors fear that older investments will be honored rather than their own. Servicing the debt requires internal (public to government) and external (Morocco or Turkey to rest-of-world) transfers. Potential investors reasonably fear that such a debt overhang raises the probability of future tax increases; domestic investors may fear crowding-out effects. The many claimants on the public purse raise uncertainty for new investors, deterring investment.

Since continued growth and job creation in Morocco and Turkey are in the national interests of the European Union and the United States, an since debt overhang may impede these goals, debt cancellation shoulc be seriously considered. Debt cancellation would also provide useful short-run political benefits, particularly in Morocco. Stability in Moroc and Turkey is as important as stability in Poland or Egypt. We should offer the Moroccans and the Turks the same treatment; their policy records to date fully merit it, certainly as much as the Egyptians' .

The success of Turkey is at once the most vital and, fortunately, the mc likely. Turkey has the most advanced economy in the region (apart fror Israel). It has a very well-developed business class, a competent government that has implemented partially successful economic reforr and it enjoys considerable land and water resources. Its labor force is growing more slowly, and job creation and private investment have been stronger, than in other countries in the region. Policy makers mus not forget that an unstable or hostile Turkey would fundamentally change the entire equation in the region. If we ask our EU allies not to cave in to particularistic economic pressure groups, we should practice what we preach with respect to our own domestic Greek and Armenia lobbies. The national interest must come first. Despite the end of the Soviet Union, Turkey remains as crucial as ever to Western security.

A final implication: We must continue to stress the necessary role of open markets to the success of the peace process. Both Jordan and Israel have gone some distance toward reforming their economies. On if Palestinians can work, buy and sell in Israel is there any hope of successful growth in the autonomous areas. Israel rightly insists on opening Arab markets to its products. Although the economic dimension of the peace process rarely receives the same attention as tl political- military aspects, it is no less vital.

Both the size and the endowments of the countries of the Levant strongly suggest focusing on the export of light industrial goods and services, which are human-capital intensive.(11) The total population o the area, including Israel, is approximately 30 million. This may be compared with the 23 million Scandinavians or the 25 million citizens the Benelux countries. The region has few and fragile natural resources accordingly, any development strategy based on the exploitation of natural resources is doomed. In the Mashreq, as in North East Asia, the only abundant resource is the ultimate resource, human beings. The human capital of the Mashreq is the highest in the Arab world, while Israel has world-class skills.

There are ample opportunities for technology transfer, a century of conflict notwithstanding. Just as the Koreans and the Taiwanese learne much from their hated former occupiers, the Japanese, the Palestinian: have acquired valuable lessons from Israel. Palestinians have obtained wide variety of specific technologies from Israelis and have absorbed the lesson that education is crucial to economic survival in the modern world. Today's Israel is, after all, a prototype of a "human-skills-intensive" development strategy. Determination to catch up with unloved but grudgingly admired neighbors is often a development asset.(12) Reducing regional tensions, forging more responsive market economies and creating (or, in Israel, extending) democratic practices will be needed if this strategy is to succeed.

Despite the daunting challenges facing the region, we should rememb that history is full of surprises. Thirty years ago, Asia was the scene of brutal upheavals like the Great Leap Forward and the war in Indochina Korean incomes in 1960 were roughly equal to Egypt's. Today, Koreans are ten times richer than Egyptians; China boasts the fastest growing economy in the world; and even the Vietnamese economy has begun t take off. Our library shelves sag with books about the "Asian miracle." Perhaps, 30 years from now our children will browse among volumes (the "Middle Eastern Awakening." We can hope for success, while takin(practical steps to help the only people who can really meet the challenge, market-oriented Middle Eastern political leaders.

(1) The author wishes to thank William Quandt for helpful comments c an earlier draft of this article.

(2) According to the ILO, a worker is unemployed if he or she has done zero hours of work for pay during the preceding or reference week.

(3) In the United States in 1990, the total **unemployment** rate was 5.5 percent; that for 16-19 year olds, 16.2 percent, for 20-24 year olds, 9.6 percent, and for those 25 years of age and older, 4.4 percent. In the same year, total official **unemployment** in Algeria was 18.4 percent; f 15-19 year olds, 64 percent; for 20-24 year olds, 46 percent, and for 2529 year olds, 17 percent.

(4) Christian Morrisson, Adjustment and Equity in Morocco. Paris: OECI Development Center, 1991, p. 46.

(5) According to the World Bank, comparable rates of labor force growth (1985-2000) are: East Asia: 1.8 percent; Latin America: 2.6 percent; South Asia: 2.2 percent; Sub-Saharan Africa: 2.6 percent.

(6) For example, over half of all Algerians, roughly one-third of all Egyptians, and two-fifths of Jordanians and urban Yemenis work for tl state. Public sector employment is less dominant in Tunisia (about 20 percent) or in Morocco (less than 10 percent).

(7) The rate of growth of the demand for food is given by the formula: D*=n+ey*, where D* = rate of growth of demand; n = population growth rate; e = income elasticity of demand for food; and y* = rate (growth of per capita income.

(8) All data in this section were taken from the FAO Production Yearbooks.

(9) Tunisia is a very important exception. Although that country has ha difficulty privatizing---for the same reasons as other Arab-nationalist regimes- its history of pragmatism in development since 1969 has paic off. In a manner reminiscent of the Mexican PRI under Salinas, "the leopard has changed its spots." This is a hopeful example for other regimes with similar historical origins.

(10) Paul Krugman, "The Uncomfortable Truth about NAFTA," Foreign Affairs, November/December 1993, pp. 13-19.

(11) John Waterbury and I called this "the strategy of the watch-maker: (Alan Richards and John Waterbury, A Political Economy of the Middle East, Boulder, CO: Westview Press, 1990, Chapter 3).

(12) For example, the technology for plastic greenhouse cultivation moved from Israelis, to Israel Palestinians in Galilee, to West Bankers, t Jordanians.

Richards, Alan, Economic roots of instability in the Middle East.., Vol. 4 Middle East Policy, 09-01-1995, pp 175(13).